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COVER STORY

Hey, investor, leave that super alone

LATE last year, just as excessive debt was beginning to undo corporate hot shots and personal investors alike, the Federal Government paved the way for self-managed super funds to borrow to invest in property using instalment warrants (see story, page 8).

"I certainly have misgivings," says Phil Jaquillard of super fund administrator SuperGuardian.

Jaquillard says people are attracted to negative gearing outside super – they get a tax deduction at their marginal rate to compensate for the deficiency between the interest payments on the investment loan and rental income from the property. But in a super fund it's more complicated.

For starters, interest rates are likely to be higher because instalment warrants are built around a non-recourse loan. If the borrower defaults, the lender's recourse is limited to the proceeds of the sale of the underlying assets. Jaquillard says the rates currently being quoted are about 10 or 11 per cent. "If the interest rate is 10.5 per cent and the long-term rate of property appreciation is about 10.5 per cent, what's the point?"

Factor in rental returns of about 5 per cent a year and outgoings for land tax, rates and maintenance, and investors can easily end up with a significant negative cash flow each year.

Because super funds pay tax at a rate of only 15 per cent, or none at all in the pension phase, there is not the same potential for high-income earners to derive a tax benefit from negative gearing.

This means that any negative cash flow must be funded by other assets in the fund or additional contributions by members.

"[Borrowing to invest in property within super] is not straightforward and needs careful analysis," Jaquillard says. "Don't just jump in because it made sense as an individual on the top marginal tax rate."